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Can risk management boost the supply of affordable housing development and management?

Abstract:

Purpose – The purpose of this paper is to analyse the risk management process conducted by some private and not-for-profit affordable housing providers in South East Queensland, and draws conclusions about the relationship between risk assessments/responses and past experiences.

Design/methodology/approach – In-depth interviews of selected non-government housing providers have been conducted to facilitate an understanding of their approach to risk assessment in developing and in managing affordable housing projects. Qualitative data is analysed using thematic analysis to find emerging themes suggested by interview participants.

Findings – This study find that informal risk management process is used as part of normal business process in accordance with industry standards. Many interviewees agree that the recognition of financial risk and the fear of community rejection of such housing projects have restrained them from committing to such investment projects. The levels of acceptance of risk are not always consistent across housing providers which create opportunities to conduct multi-stakeholder partnership to reduce overall risk.

Research limitations/implications – This study has implications for developer or investor who seek to include affordable housing as part of their portfolio. However, data collected in this study is a cross section interviews which will not include the impact on recent tax incentives offers by Australian Commonwealth Government.

Practical Implications - This study suggests that implementing improvements to the risk mitigation and management framework may assist in promoting the supply of affordable housing by non-government providers.

Originality/value – The focus of this study is the interaction between partnerships and risk management in development and management affordable rental housing.

Keywords:

Affordable housing, Housing affordability, Partnerships, Risk management, Financial risk, Risk assessment

1. Introduction

Housing affordability is a growing problem for lower income groups in Australia. An increasing demand for housing has led to rising house and rental prices and to a consequent decline in housing affordability. In this context, affordable housing is the term given to that part of the rental and home ownership market represented by lower-income groups (the bottom 40 per cent of households by income distribution) (Department of Housing, 2005). Affordable housing providers need to consider "appropriateness of the dwelling, housing and social mix, tenure choice, location of housing, quality of environmental planning and design and cost" as well as, the income status of home owners/renters (Department of Housing, 2005). Despite the rising demand for affordable housing, this area has not been seen as being "commercially viable" for housing developers, and there has been limited investment in this area by the non-government housing sector.

Investors will generally expect a higher return for a higher risk project. Affordable housing is expected to provide lower returns than market-based housing, whilst incurring a similar or higher risk (Miles, Berens, Eppli, & Weiss, 2007). The increasing scarcity of land and rising building costs are further disincentives (Residential Development Council, 2007). Risk management has, therefore, become important in such low-return investments.

The Australian Standard defines risk as "the chance of something happening that will have an impact on objectives". (Standards Australia/Standards New Zealand, 2004, p.4). Risk can also be defined as the uncertainty of such future events that might influence the achievement of one or more objectives such as the organisation's strategic, operational and financial objectives (Hillson & Murray-Webster, 2007). While the negative aspects of risk are usually emphasised, risk management may also produce positive opportunities for developers (Webb, 2003). This study defines risk as the uncertainty of outcome which may have a positive opportunity or a negative effect on project objectives.

This study follows up on a preliminary report on the results of stakeholder interviews which were conducted by this author (Susilawati & Armitage, 2004). This report recommended the establishment of effective partnerships between various affordable housing providers as a method of achieving the most successful delivery of such housing. The aim of this study is, thus, to analyse and to describe the risk management processes conducted by affordable housing providers in South East Queensland. In-depth interviews of non-government (private and not-for-profit) housing providers have been undertaken to assist in understanding the risk assessment and response processes employed by these providers when developing and managing affordable housing projects in partnership with other stakeholders. How they identify major risk factors, how they assess and respond to these, and the nature of the relationship between these processes and past experiences will also be explored in this paper.

2. Risk management in affordable housing development and management

Risk management is 'an iterative process consisting of well-defined steps, which, when taken in sequence, support better decision-making processes by contributing greater insight into risks and their impacts' (Standards Australia/Standards New Zealand, 1999, p.iii). Most definitions of risk management relate to the process of identifying, and of analysing the likelihood and impact of risk, of evaluating it, of dealing with it, and of monitoring and communicating information about it (Kim & Bejaj, 2000, p.38).

Risk management should be integrated into 'the philosophies, practices and business plans' that make up an organisation's culture (Hillson, 2002, p.241; Standards

Australia/Standards New Zealand, 2004, p.v). Risk management requires human judgement at the individual, group and organizational levels (Hillson & Murray-Webster, 2007). Hillson suggests that project managers manage risks 'continuously, both consciously and unconsciously, though rarely systematically' (Hillson, 2002, p.240). Risk management begins with the establishment of context, proceeds to risk identification, and then to risk assessment or analysis, and finally, to risk response and mitigation (Standards Australia/Standards New Zealand, 2004, p.9).

Past experiences of risk may affect a developer's risk response strategies. Many respond to risk by having contingencies for risk mitigation. This might include sub-contracting the work to transfer risk, or the purchase of insurance. Others might just accept the risk (Hillson & Murray-Webster, 2007; Melton, 2007).

A risk management policy is usually created to formally identify and to manage the risks of events that may have major implications for the organisation. The areas of impact of these events may be varied, and can include risks associated with finance, human performance, tenancy management and reputation. Such risks may impact on the organisation, staff, tenants and/or on various stakeholders (Robinson, 2006).

The tools most commonly employed to measure such risks include qualitative techniques (Elenor, 2006). Webb (2003) called these 'likelihood and consequences' tools and Melton (2007) described them as 'probability and impact analysis' tools. The quantitative measurement of probabilities or likelihoods is difficult, particularly where such probabilities are low. For this reason, probability (or likelihood) will be defined in this study by the 'low, medium and high' qualitative criteria. The consequences of risk can be measured by both quantitative and qualitative techniques. Financial consequences are easily measured in terms of financial impacts on the organisation. Non-financial consequences may include the failure to achieve a desired outcome for a tenant, employee or stakeholder. Table 1 shows the qualitative risk analysis matrix. Categories of risk evaluation shown in Table 1 are in the low/medium/high risk range.

Table 1. Qualitative Risk Analysis Matrix

	Low Consequence	Medium Consequence	High Consequence
High Likelihood	Medium Risk	High Risk	High Risk
Medium Likelihood	Low Risk	Medium Risk	High Risk
Low Likelihood	Low Risk	Medium Risk	Medium Risk

Source: Data from Elenor, 2006, p.26

Risk Management for Community Housing concerns the core functions of affordable housing providers. These functions are: land procurement; housing development; asset management; property management; tenancy management; and, community building (Bisset & Milligan, 2004, p.56). A similar focus for risk management can be also found in the broader rental market, where low-income people are forced to find alternative accommodation due to the lack of affordable housing.

The main goal of any private organisation is to maximise profits by maximising income whilst minimising costs. The main income from rental fees in the broader rental housing business is derived from property which is maintained in good condition. The main operational costs of such rental housing are, thus, maintenance works and repairs. The major goals of the managing agent are to maximise rental income whilst minimising maintenance costs. These agents will be able to minimise their business risk if they can select good tenants who usually pay their nominated rent on time, and are willing and able to take good care of the property (Short, Seelig, Warren, Susilawati, & Thompson, 2008). The process of tenant selection has a strong focus on selecting a tenant with the ability to pay the rent (a good financial capability) and the ability to care for the property (a good rental history). In a low vacancy housing climate, many agents are reluctant to include many low-income tenants in their preference listing process in order to minimise the risk to them of rental arrears (Short et al., 2008).

3. Methodology

This study is based on data collected from a series of interviews conducted in South East Queensland from October 2007 to February 2008. These interviews focussed on the risk management process during the implementation of affordable housing projects and subsequent associated management phases. The interviews sought to identify challenges and associated strategies for risk minimisation which particularly require stakeholder partnership arrangements. The network of interview contacts developed through a snow-ball sampling technique based on referrals from initial interviews. The interviewees comprised major stakeholders who are participants in an affordable housing providers' organisation which develops and/or delivers services for low-income tenants.

Nineteen interviewees work for ten not-for-profit and six private organisations (see Table 2). They have direct involvement in developing and managing affordable housing in Brisbane and surrounding region (beyond the Brisbane City Council) in South East Queensland were selected for interview in this study. Two interviewees who were not implemented but actively analysing new affordable projects were included in the interview process.

Table 2. Profile of Interviewees

Organisation	Interviewee	No. of Organisations	Gender
Not-for-profit	13	10	5 Male 8 Female
Private	6	6	3 Male 3 Female

This study uses thematic analysis to analyse qualitative data which will find the main issues suggested by the interviewees. Identified themes have also been categorised as one of the main themes in risk management, which include risk identification, risk assessment and risk responses. In addition to the interview questions, interviewees were asked how risk management was conducted within their organisation (see Table 3).

4. Analysis and discussion of interview results

Risk management is conducted mainly as an informal process by each organisation (see Table 3). While this is specified as part of their standard operating procedures, not all organisations have a formal risk management and risk registration process, or an appointed officer to plan, to conduct, and to monitor the risk management process in their organisation. Six organisations undertake formal risk assessment for every project, but ten conduct risk assessment informally using a qualitative probability-impact matrix as part of their corporate policy. If the organisation's main goals are delivering affordable housing which is to be delivered under a government-subsidised program, then this organisation will have to have a formal risk management process as part of their accreditation procedure.

One company stated that they would identify project risks via a three-stage process which consisted of a consideration of the risk management matrix, which was then followed by a due diligence and risk assessment study. This company conducts informal risk identification in the due diligent process, employing constraint analysis (Strength-Weakness-Opportunity-Threat (SWOT) format), and also property, market and financial analysis. This internal process has a very important role in this company's decision-making, for they hold that it is better to cancel risky projects at an early stage.

Only two organisations have a formal risk assessment process that is applied after the initial 'due diligence' process. One of the not-for-profit organisations has a full-time risk management officer. His role is to ensure that the organisation's policy complies with current government legislations and accreditations. This formal process aims to ensure that the organisation's reputation will not be affected by any proposed development. This particular risk assessment process is part of this company's standard operational procedure (SOP) and it is supported by a computerised risk register database and by a monitoring system.

Table 3. Risk management experiences by number of organisations

No	Description	Number of not-for-profit organisation (10)	Number of private organisation (6)
1	Conduct risk management - Formal risk management - Informal risk management	 6 4	 0 6
2	Have experience of developing or managing 'affordable housing'	10	4
3	Have partnership(s) to deliver or manage 'affordable housing'	10	3
4	Risk experience related to tenants: - unable to pay rent (bad debt) - property damage - high turn-over of tenants (vacancy) - reluctance to take low income and high needs tenants	 6 6 1 3	 4 1 1 3
5	Rental fee charged: - discounted market rent - income-based rent (for public and community housing)	 8 7	 3 0

Affordable housing management is thought to be associated with a higher risk than private real estate management because of bad debts, higher turn-over of tenants (higher vacancy levels) and because of a higher risk of property damage. Six interviewees mentioned their reluctance to take on risks associated with renting to low-income households, and especially, to those with special or more complex needs. Since eleven affordable housing providers set rental payments based on a discounted market-based rent rather than on income-based rent as paid in public housing, the rent default rate may be higher in the former situation**.** As one interviewee observed "You can expect there will be a problem with paying the rents, with property damage, and with anti-social behavioural problems". Much of the problems are not, however, caused by the tenants themselves but by associates of the tenant. An over-crowded house can develop problems of hygiene and excessive noise, and this has the potential to lead to property damage. On-site care-takers or pseudo on-site management has helped to reduce such risks for some properties.

Thirteen organisations studied have partner(s) to deliver and to manage the affordable rental/ownership housing. In general, an organisation needs to assess the viability of the investment and to evaluate the partnership selection process for any property development/investment decision. An organisation will have to meet not just this investment and partnership criteria, but also the location and cost criteria for affordable housing criteria as defined by the Queensland Department of Housing. This requires that affordable housing should be "well located in relation to places of employment and to the range of services, facilities, communication and transport networks required to meet other household needs." It is also critically important, as one interviewee declared, that "we have a good design, a good location, a good affordability, a good social mix and, are not creating a ghetto".

Decisions regarding affordable housing investment/development can, thus, be represented as a three part process by this researcher's diagram in Figure 1. These decision-making criteria are interconnected and may impact total cost of providing affordable housing for lower-income people. The first criteria, location and cost of affordable housing criteria, (which are applied in each affordable housing project) have already been discussed above. The main issue in the second criteria, that of partnership criteria, is an inequity level among partners because of the associated financial risk, for as one interviewee noted "it is important to share a common value and have the right affordability mix in each project". Another interviewee stated that a partnership is not an easy situation to manage and that it is like having "too many cooks in the kitchen". The third criteria - investment criteria concerns the Corporate Policy of the involved organisation. This involves the organisation's economic, social, political and legal investment criteria.

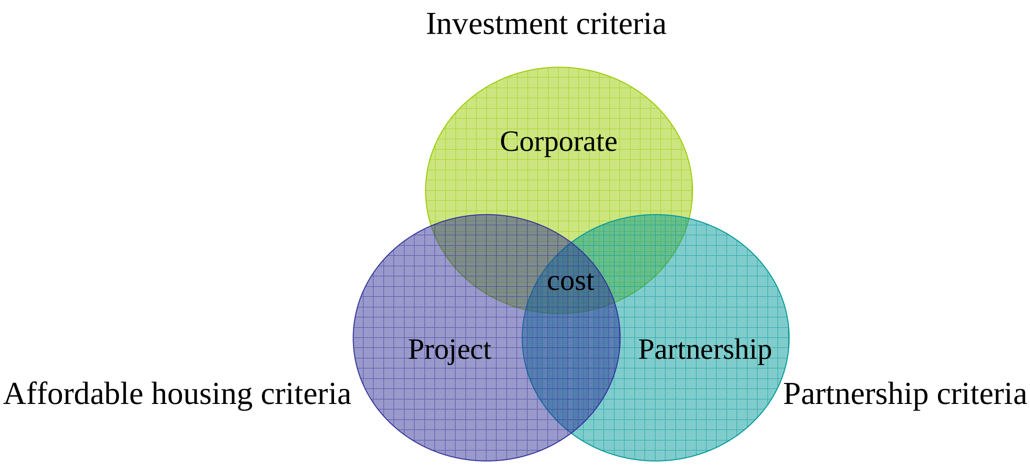

Figure 1. Interconnection between decision-making criteria related to risk assessment
Even though the affordable housing project is considered a risky investment, some projects have been engaged in due to the new partner's trust in the existing capability of the main partners. Strategic partnerships can, moreover, be formed in which each partner has his/her own unique role. This might involve a developer wishing to invest in a viable project in partnership with a not-for-profit organization who will manage the development in the interest of producing a good social outcome. Eight interviewees referred to the benefits of forming such strategic partnerships. Two specifically referred to the desirability of analysing partnership projects on the basis of "partnership reputation and performance of other development work".

The interview results for identified risk management themes have been collated by number of organisations and these are displayed in Figure 2. Nine organisations stated that affordable housing is not a preferred property development and, therefore, that they had had to leveraged its market risk. The physical features of affordable housing are not those preferred by the community seeking accommodation. These include medium to high density development, smaller room sizes and limited carpark facilities in multi-unit residential developments. The limited legal rights to the use of the land such as caveats or land covenants which enforce the land have to be used for affordable housing for at least ten years, will also influence the property value.

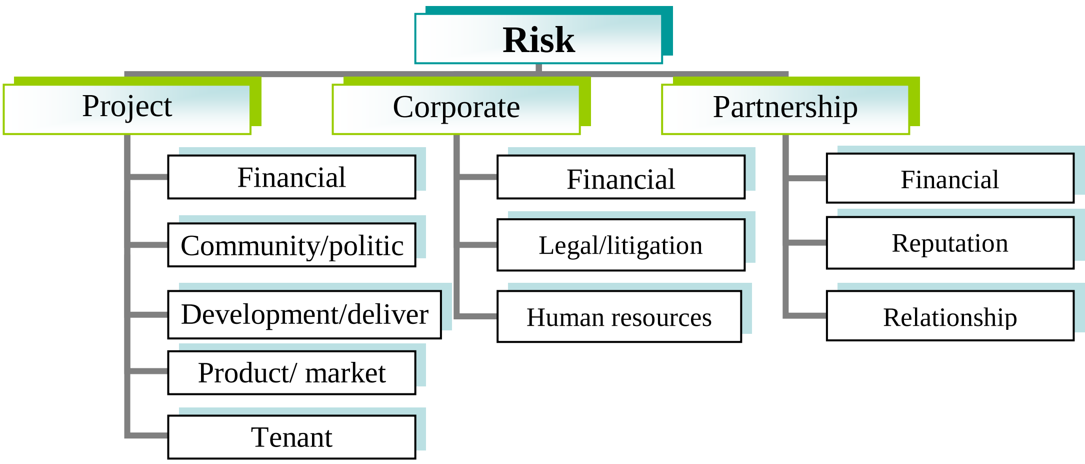

Figure 2. The main risk categories at the project, corporate and partnership levels

Couple housing providers have considered investing in affordable housing but have not yet implemented any new development and affordable housing development is seen by these as an opportunity to be approached with caution. Nine participants agree that fear of financial risk, community rejection and development approval risk have dominated their current hesitation in entering into risky investment projects. The increment of development and maintenance costs are also major risks stated by fifteen organisations in project level.

Figure 2 categorises the three levels of risk in affordable housing development and management - the project level, the corporate level and the partnership level. All participants have nominated financial risk as a major consideration at all these levels. . Although risk of litigation also is considered to be equally important, the interviewees' were concerned about this mainly at the corporate level. In selection of partner(s), the reputation of the partner becomes very important in the selection of a new partner and this is seen to have the greatest impact at the corporate and project level.

Interviewees have a divergent views towards risks associated with reputation and tenants. The reputation risk is associated with the reputation of partners. Since many partners lack experience in affordable housing developments, this judgement will be made on the basis of reputation related to the handling of other projects. The interviewees were divided also, over the risks of attracting stigma associated with affordable housing tenants. Not-profit-organisations accepted the risks associated with low income tenants more readily than did private developers, since these organisations have had more extensive experience in managing community housing which targets low-income tenants and those with special needs.

Housing providers mentioned that the current government incentives for providing affordable housing are not very attractive. Tenants needing affordable housing are not, themselves, empowered to attract an additional supply. The risk adverse attitude of most stakeholders works to hinder the implementation of collaborative affordable housing projects. A list of organisational risk responses including risk transfer, acceptance and minimisation are given in Table 4. This table lists risk minimising strategies adopted by housing providers.

Some risks have been transferred at the project level to other stakeholders via: the purchasing of insurance; and the sub-contracting out as fixed term developments to other builders; by retaining a tenancy bond; or, by selling the completed development to other institutional or financial investors. The normal insurance that the project will need is liability insurance, construction insurance, building insurance, and landlord insurance to comply with financial and regulatory requirements. For a financier, the value of land in a good location will cover the bulk of the loan amount as it has a lower loan to value (LTV) ratio than does a broader market-based housing development. Four housing providers accept a potential loss of income by budgeting for contingency costs and vacancy allowances.

A risk reduction strategy suggested by five interviewees is the targeted selection of affordable housing tenants from ‘low to moderate income’ workers in key areas - such as teachers, police, or nurses. Such key workers may not be eligible for public housing but will still be finding it difficult to find housing which costs less than 30 per cent of their income. Some organisations additionally arrange a direct debit on renters' incomes via CentreLink’s Pay Management System to ensure that the rents get paid on time, and also arrange a complaint mechanism, as well as, a regular property inspection system in order to minimise property damage risk.

Although eight housing providers have transferred some of the risk (see Table 4), they did not mentioned this as part of a risk management strategy since it is part of their business process. As mentioned earlier, the initial evaluation process is very important for minimising risk at an early stage. Seven organisations state that experienced executive and board members have an important role in the selection of a good location for affordable housing development. The planned pre-lodgement meeting and other initiatives by Urban Development Land Authority (UDLA) approach in Queensland has been recognised by local government and the surveyed organisations as valuable initiative for reducing delays in the development approval process. Two organisations indicated a favourable response for such an initiative.

Table 4. Risk responses utilised by organisations

Risk	Transfer	Accept	Minimise
Location			Valuation and board review, selection of good location
Product design/ market			Market segmentation for key workers
Community			Not ghetto, mixed housing
Government supports and political			Managing councils' expectations
Development approval (planning)			Pre-lodgement meeting UDLA's (Urban Development Land Authority) approach
Financial	Sell to investor(s)		The financier minimises the risk by low loan to value ratio
Delivery/ procurement	Fixed contract	Contingency	Fixed construction contract and contingency Strategic partnerships
Cost	Insurance	Contingency	Planned and fixed cost contracts
Tenant	Rental bond	Stigma,bad debt, damage and social behaviour problems Contingency	Centrelink direct debit facility Rental bond, community club, tenant selection process, tenant educational programs
Business	Rental bond, insurance		Management system
Reputation			Select reputable partners
Relationship			Strategic partnerships with tenants' support providers
Human resources			Staff retention program, building capacity, diversifying company employment structure

While this study has found that low income households will be included in the selection process, it also has found that the housing providers may prefer to select tenants with higher incomes in order to reduce their risk. These organisations' tenant selection process uses a similar but 'more thorough' process than does as the broader market-based housing and includes such things as checking the applicants' tenancy history, applying an income affordability check, and interviewing the potential tenants after reviewing their application form. This helps to mitigate the higher risks associated with these lower income groups. More effort is made, importantly, to achieve a good mix of tenants for a property, and to match the property to the tenants' needs. Careful tenant selection and allocation will ensure financial sustainability for the project and will reduce the likelihood of disturbances.

Five organisations also emphasised the important role of housing providers in educating tenants to empower their own economic capability thus reducing the risk of incurring bad debts. Some identified areas for education as money management, a property-care program, employment pathways, and so on. These programs help tenants to improve their current financial situations, thus enabling some to be able to move into the open housing market. Some of these programs will be delivered by the community club in affordable housing complexes. At Kelvin Grove Urban Village, the community hub in the village has been used for different activities associated with family fun, 'education' and arts. Not-for-profit organisations and private managers have reduced the perceived risks associated with the provision of affordable housing by establishing strategic partnerships. Ten of the surveyed organisations responded favourably to this form of risk minimisation. Eight organisations also referred to needing to provide additional support to tenants with special needs.

All organisations indicated support for government initiatives in this area of providing affordable housing. Support for the provision of subsidies and indirect funding through improvements to the supply of land and to planning mechanisms, as well as, for improved risk mitigation efforts was mentioned. It was suggested that: the government could provide assurance as safety net for housing providers and financial institutions; the government could offer a 'safe investment' guarantee similar to government bonds in order to generate an increased supply of affordable housing; and that a formalised risk management process could include the development of a risk register. Such initiatives would help to attract more investors to the provision of affordable housing which would then be seen as a more 'manageable though still risky' investment.

5. Conclusions

The majority of housing providers that were interviewed were not found to be using a formal risk management process in every project selection and implementation. Many considered that their normal business practice included an adequate informal risk management process. As an industry standard, a simple qualitative matrix is utilised at the organisational level to analyse risk probability and impacts on a qualitative scale (low, medium and high). Due diligent is used in the development stage to filter the viable projects for implementation, and finally, an informal risk assessment process is normally used in the selection of strategic partnerships and in the selection of appropriate prospective tenants.

The provision of affordable housing developments and their management have, so far, been seen as 'risky' investments. Not only have such projects had to meet the affordable housing project criteria but also, have had to meet organisational partnership and investment criteria as well. The identified risks have been categorised under three level of risk in affordable housing development and management – the project level, the corporate level and the partnership level. Private organisations are more concerned with the financial risks associated with the provision of affordable housing. This concern is focussed on the impact of the stigma associated with lower-income tenants and their association with affordable housing. These are thought to have an impact on the long-term sustainability of the investment at both the operational, as well as, at the disposal stage. This has led many to seek active strategic partnerships with community-based organisations to mitigate this risk. By contrast, not-for-profit organisations who have had more experience with low-income groups and in managing community housing, have a slightly different attitude toward tenant risk. They generally accept it as a given risk, form strategic partnerships with tenant-support providers, and then minimise it by budgeting for it as a contingency cost.

A well-managed community housing organisation with a formal risk management strategy is, clearly, in a strong position to attract private investors as partners in supplying affordable housing. Recent Government interventions, such as through planning schemes and policies within the Urban Land Development Authority (ULDA), and new initiatives, such as tax incentives developed through the National Rental Affordability Scheme (NRAS), will assist in providing more certainty for housing providers and this will significantly reduce such investment risks. The surveyed affordable housing organisations hope that such interventions can be delivered in the form of grants, and by direct and indirect subsidies and government guarantees.

For housing providers who have considered investing in affordable housing but have not yet implemented any projects, affordable housing development is seen as an opportunity that must still be approached with caution. The identification of risks and the levels of acceptance of such risks are not uniform across the current affordable housing provider community. Many interviewees agreed that the awareness of financial risk and the fear of community rejection of affordable housing have led to a reluctance of housing providers to become involved in such risky investment projects. This study suggests that an improvement to the risk mitigation/management framework may assist in enhancing the supply of affordable housing.

Further study is needed to evaluate the effectiveness of having a mixed investment portfolio mix with different types of housing rather than of just catering for stand-alone affordable housing projects. This portfolio mix could consist of mixed housing products, mixed-use housing and commercial developments, better strategic partnership arrangements, the provision of more public infrastructure, and a wider selection of tenant groups. The issue of an improved portfolio mix and partnership/tenant challenges need to be resolved to encourage more investment in affordable housing.

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